LINCOLN AVENUE CAPITAL

Filling Gaps Through Basis Maximization Strategies

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Reducing the Need for State Tax Credit Through Basis Maximization Strategies
(Background & Overview)

Background

- –The compelling financial attribute of the 4 percent LIHTC program is the "as of right" credits that come with meeting the IRC Section 142 requirements along with meeting the threshold requirements set forth in SC Housing's QAP.
- –While Private Activity Bond (PAB volume cap is a limited resource, the credits associated with TEB transactions are only limited underwriting and the amount of eligible basis. This is a significant difference from the 9 percent LIHTC program where the allocation of annual credit authority is capped.
- –To combat escalating construction costs, inflation and rising interest rates, SC Housing should take affirmative steps to allow bond transactions to maximize eligible basis to leverage the maximum amount of LIHTCs within the constraints of the law.
- –This approach also reduces the need to leverage scarce SC State Tax Credits.

Fill Project Gaps By Leveraging Additional Developer Fees

- –The IRS permits the inclusion of developer fees in eligible basis because these fees serve as the primary form of compensation for LIHTC developers. They pay for overhead of essential functions, including accounting, human resources, information technology, asset management, insurance and legal fees and many others.
- –Developer fees serve as the primary form of reimbursement for pre-development costs and resident services and are a de-facto construction contingency, much drawn on today as construction costs skyrocket.
- –Even small increases in developer fees for bond transactions can fill significant project funding gaps. This is a policy strategy that has been deployed by many states HFAs in recent years to great success

New Construction Case Study

Scenario A: Current QAP Language	
Total units	150
Construction Cost (per unit)	$ 200,000
Interest Rate	5.3%
Deferred Developer Fee	0
Total Developer Fee	$ 3,000,000
Federal LIHTC Equity (Annually)	$ 1,996,770
Total Federal Equity	$ 17,366,154
STC Required (Annually)	$ 1,457,160
Total State Equity	$ 7,285,072

Scenario B: 15% Developer Fee	
Total units	150
Construction Cost (per unit)	$ 200,000
Interest Rate	5.3%
Deferred Fee	$ 3,380,930
Total Developer Fee	$ 5,308,711
Federal LIHTC Equity (Annually)	$ 2,116,194
Total Federal Equity	$ 18,410,891
STC Required (Annually)	$ 1,058,097
Total State Equity	$ 5,289,957

Scenario C: 20% Developer fee	
Total units	150
Construction Cost (per unit)	$ 200,000
Interest Rate	5.3%
Deferred Developer Fee	$ 5,298,556
Total Developer Fee	$ 7,079,400
Federal Equity Annually	$ 2,209,074
Total Federal Equity	$ 19,214,403
STC Required (Annually)	$ 883,421
Total State Equity	$ 4,416,662

Project Overview: 150 Unit New Construction Project. Federal Equity priced at $0.87. State Equity priced at $0.50.

- **Scenario A** shows the original pro-forma assumptions, utilizing SC Housing's current QAP developer Fee methodology.
- **Scenario B** shows the additional federal LIHTC equity proceeds generated if the fee is raised to a flat 15% reducing the annual state credit request by $400k. Note the paid developer fee is lower than in scenario A.
- **Scenario C** shows the additional federal LIHTC equity proceeds generated if the fee is raised to a flat 20% reducing the annual state tax credit request by $570k. Note the paid developer fee is lower than in scenario A.


Thank You.
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